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SMALL BUSINESS ADMINISTRATION 1953

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

Comments of the Chief Counsel for Advocacy
of the United States Small Business Administration
on the Notice of Proposed Rulemaking

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August 25, 1993

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I. *Introduction*

On October 5, 1992, the United States Congress, pursuant to Article I, § 7, cl. 2, overrode a veto and enacted the Cable Television Consumer Protection and Competition Act (Cable Act or 1992 Act) into law.[1] The Cable Act was passed to reduce the perceived abuses of customers and competitors by cable operators.

Implementation of the 1992 Act requires extensive rulemaking by the FCC.[2] The instant rulemaking, In the Matter of

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[1] Pub. L. No. 102-385, 106 Stat. 1460 (1992) (codified, as amended at 47 U.S.C. §§ 521-59). Citation to the Cable Act will be made to the public law not the codification.

[2] The 1992 Act mandates approximately 25 separate rulemakings on issues from rate regulation to program access for
(continued...)

Implementation of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation, MM Docket No. 93-215 (July 16, 1993) (NPRM), *summarized in* 58 Fed. Reg. 40,762 (July 30, 1993), effectuates that portion of the 1992 Act that authorizes both the Federal Communications Commission (FCC or Commission) and local franchising authorities to regulate the rates of cable operators. This rulemaking examines an alternative to the benchmark pricing scheme developed by the Commission in MM Docket No. 92-266 for the regulation of rates.[3]

The 1992 Act provides for bifurcated regulatory power over rates. Local franchising authorities[4] are authorized to regulate the rates of basic cable service[5] according to the

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[2](...continued)
alternative multichannel video delivery systems. The Cable Act also mandates the Commission undertake a number of inquiries and make recommendations to Congress spanning such issues as consumer electronic compatibility to migration of sports events to pay-per-view cable.

[3] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Report and Order, (May 3, 1993), *summarized in* 58 Fed. Reg. 29,376 (May 21, 1993) (hereinafter Report and Order).

[4] Under the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2870, (codified as amended at 47 U.S.C. §§ 521-59) (CCPA) all cable operators must obtain a franchise from an appropriate local governing authority. The Cable Act does not modify that requirement.

[5] Basic cable service is defined as any tier of service that includes the transmission of local over-the-air broadcast signals, public access channels, and any government-owned channels.

standards prescribed by the Commission.[6] The FCC is empowered to regulate the rates of cable programming services[7] to ensure that those rates are not unreasonable.[8]

On December 24, 1992, the Commission issued a notice of proposed rulemaking to paint the details on the canvas constructed by Congress. Nearly 200 parties responded to the notice and another 120 parties, including the Office of Advocacy, filed reply comments.[9] The Office of Advocacy requested that the FCC develop a regulatory scheme that reduces administrative burdens on small cable operators and local governments even if it sacrifices some exactness in the establishment of rates.

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[6] The Commission was directed to develop a regulatory regime to ensure that rates charged for basic cable service are reasonable.

[7] Cable programming services are all cable programming services other than those programs that constitute basic service. However, cable programming service excludes pay-per-view service and those programs sold on an individual basis such as HBO or Showtime.

[8] The FCC has determined that the same rate regulatory principles should apply to both basic and cable programming service. Report and Order at ¶ 389.

[9] In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Notice of Proposed Rulemaking, Comments of the Chief Counsel for Advocacy (February 23, 1993) (hereinafter Comments of the Chief Counsel).

Comments of the Chief Counsel at 14. The FCC waded through this voluminous record rather admirably given the staff shortages and statutory deadlines that had to be met.[10]

The Commission determined that normal cost-of-service[11] rate regulation would not be the least burdensome rate regulatory methodology. Cost-of-service regulation would entail individual rate determinations for some 11,000 cable systems by some 20,000 local franchising authorities. The FCC staff would have had to make similar determinations concerning cable programming service. Despite that finding the Commission recognized that in some instances, operators would prefer to use cost-of-service regulation rather than the primary regulatory scheme developed by the Commission.

Instead of rate-of-return regulation, the Commission adopted a concept from its regulation of dominant common carriers --

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[10] The 1992 Act required many of the 25 rulemakings to be completed within 180 days. Coetaneous with this massive work burden, Commission staff was faced with potential furloughs due to budgetary constraints. As a sister federal agency, the Office of Advocacy applauds the efforts of the Commission even though we may disagree with the outcome of a particular rulemaking.

[11] Under cost-of-service or rate-of-return regulation, a regulated entity submits a rate request to a regulatory agency along with extensive cost data. From this information, a rate for the service is calculated that ensures the entity will recover all costs for providing the service and earn a specified return on its investment.

price caps.[12] In the context of cable service, the FCC found that cable rates for systems which did not face effective competition[13] were ten percent higher than those that did. This led to the development of a benchmark per channel charge for basic and cable programming service. Report and Order at ¶¶ 213-20, 393-98. These benchmarks are then modified annually to take account of inflation, programming costs (which are passed through to customers),[14] and certain other exogenous costs (costs outside the control of the cable operator). *Id.* at ¶¶ 223-57.

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[12] Rates charged by common carriers for interstate interexchange service are subject to regulation pursuant to Title II of the Federal Communications Act of 1934, 47 U.S.C. §§ 151-609. Dominant common carriers subject to such rate regulation include AT&T (the only interexchange carrier so designated) and all local exchange carriers (LECs).

Price caps do not deregulate the provision of interexchange service; rather it simply provides an alternative means by which the FCC can ensure reasonable rates -- the same linchpin driving regulation of cable operators. The touchstone of price caps is the imposition of price limits on baskets of services rather than mandating a tariff that will provide a specific rate of return to the carrier.

[13] Effective competition exists when the penetration rate for cable service is less than 30 percent (penetration rates refer to the number of households actually receiving cable service in relation to the total number of households passed by the cable system), or an unaffiliated multichannel video program provider offers comparable service to 50 percent of the community and has a penetration rate of at least 15 percent. Cable Act, § 3(1)(1).

[14] The Office of Advocacy requested that such a pass-through be established. Comments of the Chief Counsel at 18-19.

While benchmarks and price caps represent the primary scheme for rate regulation, the Commission concluded that cost-of-service showings should be permitted for operators that cannot operate profitably under the benchmark standards. *Id.* at ¶¶ 262-64, 400-02. According to the FCC, this backstop is necessary because the benchmarks are derived from general industry data[15] and a specific system's costs may not be accurately reflected in this data. *Id.* at ¶¶ 262. The Commission did not develop cost-of-service standards in the prior rulemaking despite the severe impacts that benchmark regulation might impose on cable operators. The FCC, recognizing the potential adverse consequences, decided to initiate the instant rulemaking to establish the process for making a cost-of-service showing. NPRM at ¶ 1.

II. *The Impact of the Report and Order on Small Firms*

There are roughly 11,000 cable systems in the United States. Of these, nearly two-thirds have revenue of less than 7.5 million dollars.[16] While all cable operators will feel some impact,

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[15] As part of the rulemaking in MM Docket No. 92-266, the Commission randomly surveyed some 300 cable systems for price and cost data. A detailed exegesis on the results of that survey can be found in Appendix E to the Report and Order.

[16] The number of cable systems does not coincide directly with the number of small businesses that operate cable systems. Some cable operators own more than one system (multiple system operator or MSO). Some MSOs are very large (the largest 25 MSOs (continued...)

benchmark rate regulation will have a disproportionate impact on small systems and, especially, small operators.

Most small operators do not have the administrative resources to cope with the complex rules established by the FCC to implement rate regulation.[17] This lack of capacity is not limited to systems with less than 1,000 subscribers -- the focus of the Commission's efforts to reduce regulatory burdens; rather many small operators above that size face similar obstacles in complying with the regulations.

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[16](...continued) provide service to approximately 80% of the subscribers of cable service). Other MSOs are small with revenue of less than 7.5 million dollars -- the cutoff for a small cable operator adopted by the Small Business Administration pursuant to the Small Business Act. No accurate data has been compiled by the FCC that could distinguish between single operation systems, small MSOs, and very large MSOs. As a result, the reference to the number of small cable systems adversely affected by rate regulation is, at best, a surrogate for the small operators involved in the cable industry.

[17] Rate regulation represents only one aspect of the increased regulatory burden on small operators. They also face substantial new costs associated with negotiating retransmission consent agreements. The 1992 Act requires cable systems to carry all local over-the-air broadcast signals or pay for retransmission of such signals if they do not choose to carry all signals that qualify for carriage. Previously such signals were retransmitted without payment under the compulsory license issued to cable systems by § 111(c) of the Copyright Act of 1976, 17 U.S.C. § 111(c). Other administrative costs are imposed due to new customer service standards and equal employment opportunity monitoring.

Many small operators, as prior Commission studies have shown,[18] do not price their services to maximize profit or revenue because their subscribers are often rural residents with limited financial resources. The operation of the benchmarks along with price caps locks these systems into relatively small price increases irrespective of the financial or technological needs of the system. In particular, the benchmarks do not take account of capital recovery and the potential need for system rebuilding. This is especially vital as new technology, such as digital compression, and new competitors, such as the telephone companies,[19] are introduced. Small operators' inability to

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[18] In response to the CCPA, the Commission was mandated to report to Congress on the success of the CCPA in promoting the growth of the cable industry and any problems arising from deregulation. 47 U.S.C. § 543(h). The FCC found that rates increased at a greater pace for larger systems and those owned by large MSOs. In the Matter of Competition Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Services, MM Docket No. 89-600, Report and Order, App. G at 1 (July 31, 1990).

[19] LECs are prohibited from owning cable systems in their service areas. 47 U.S.C. § 533(b)(1). The 1992 Act did not repeal that debarment. Despite that ban, the FCC permitted these carriers to use their local lines for common carriage of video signals through a technology known as video dialtone. In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, CC Docket No. 87-266, Second Report and Order, slip op. at ¶¶ 37-61 (August 14, 1992). In addition to the inroads permitted by the FCC, strong sentiment exists with a certain segment of Congress to remove the ownership ban and allow telephone companies to directly own and operate cable systems.

The actions of the FCC on video dialtone and Congressional attitudes have been overshadowed by a federal district court decision that invalidated the CCPA bar on telephone company ownership of cable operations in their service area. Bell Atlantic Corp. v. FCC, slip op. (E.D. Va.) (August 24, 1993). The court held that the CCPA was unconstitutional because it

(continued...)

raise sufficient funds to meet these challenges may doom these companies to the same fate as the reptiles of the Jurassic Period.

Most systems owned by small operators have less channel capacity than systems owned by larger operators. This reduces their ability to obtain revenue from unregulated premium channels and pay-per-view services.[20] Nor do small operators, because of the small markets that they serve, have local advertising insertions on cable channels. Finally, the vast majority of small operators do not have access to revenues from sources other than video delivery -- an option available to a number of very large MSOs.[21] Thus, small operators that rely on cable

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[19](...continued) unduly impinged on Bell Atlantic's rights under the First Amendment.

[20] The must-carry/retransmission consent rules adopted by the Commission to implement the 1992 Act further restricts the channel capacity available to small operators for this alternate income stream. In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Broadcast Signal Carriage, MM Docket No. 92-259, Report and Order, slip op. at ¶¶ 3-129 (March 29, 1993); *see also* In the Matter of Implementation of Section 4(g) of the Cable Television Consumer Protection and Competition Act of 1992, Home Shopping Station Issues, MM Docket No. 93-8, Report and Order, slip op. *in passim* (July 19, 1993).

[21] Many large MSOs are vertically integrated and have substantial interests in cable programming channels. In the Matter of Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution and Carriage, MM Docket No. 92-265, First Report and Order, slip op. at ¶¶ 28-34 (April 30, 1993). In addition, a (continued...)

operations for their survival will feel a greater impact on their cash flow and profit than their larger competitors with alternative sources of revenue.

Finally, the benchmarks are not adapted to the unique characteristics of systems owned by small operators. The Office of Advocacy requested that the FCC develop a matrix of different benchmarks for systems with different characteristics. Comments of the Chief Counsel at 13. The Commission rejected that idea. Report and Order at ¶¶ 568-70. The failure to customize the benchmarks to take account of factors such as population density, terrain crossed, capital recovery for rebuilds, and the availability of volume discounts for larger operators only exacerbates the potential financial burdens faced by small cable operators under the benchmark method.[22]

As a result of these impacts, numerous small cable operators have contacted the Office of Advocacy voicing their concern that they cannot operate profitably, if at all, under the constraints imposed by the benchmarks. The Office of Advocacy agrees that

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[21](...continued) number of these firms have made investments in movie production companies, personal communication services, and competitive access providers.

[22] These issues and concerns were raised by a Community Antenna Television Association petition for reconsideration of the Report and Order to make the benchmarks more sensitive to system characteristics. The Office of Advocacy supports that groups petition for reconsideration.

some other process must be developed to permit small cable operators to demonstrate that the benchmarks do not let them recoup their costs, provide a fair rate-of-return, and allow for future investment in their systems. To alleviate these concerns, the FCC instituted the instant rulemaking to provide an alternative mechanism -- one that is more sensitive to system characteristics -- for demonstrating the reasonability of rates.

III. *The NPRM*

The key goal of the Commission in this rulemaking is to adopt a cost-of-service procedure that permits authorities to determine whether rates in excess of the benchmarks are reasonable given the costs of providing cable service. NPRM at ¶ 7. The FCC also recognizes that this key goal exacts a tremendous price -- the extensive administrative costs associated with cost-of-service regulation. Such costs are particularly burdensome for small entities, be they operators or local franchise authorities.[23] As a result, the Commission prepared an initial regulatory flexibility analysis pursuant to the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA). *Id.* at

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[23] Most small cable operators and local governments do not have the staff or financial resources to hire accountants, lawyers, and economists to deal with rate-of-return regulation. In fact, this was of such concern to some members of Congress that an amendment was offered during debate on the legislation (ultimately defeated) giving regulatory authority to state public utility commissions.

¶¶ 91-98. The Office of Advocacy agrees that the Commission must develop procedures that balance the need for exactitude with administrative simplicity. The Office of Advocacy believes that the Commission's experience with the regulation of common carriers pursuant to Title II of the Federal Communications Act of 1934, 47 U.S.C. §§ 201-24, may prove beneficial in developing the mechanisms to achieve that balance.

The NPRM sets forth the annual expenses (operating, programming and taxes) recoverable, offers a number of depreciation schedules, provides for valuation of plant that will comprise the ratebase, suggests various methodologies for calculating the appropriate rate-of-return, and specifies various cost allocation requirements. Taken together, these various provisions present a rather prosaic version of cost-of-service ratemaking. While these procedures may be prosaic to regulatory attorneys and sensitive to individual system characteristics, most small cable operators will feel as burdened by this regulatory approach as they are under the benchmark/price cap regime.

The Commission recognizes the burden and offers a number of alternatives to standard cost-of-service regulation. First, the FCC suggests that an appropriate alternative is to deem rates reasonable if they are no higher than 1986 rates adjusted for inflation and productivity gains.[24] *Id.* at ¶ 71. Second, the Commission proffers that only certain key factors be used to justify rates rather than all components of conventional regulation expatiated upon in the NPRM. *Id.* at ¶ 72. As a corollary to this, the FCC proposes to examine costs to determine what factor or factors account for most of the difference in rates between competitive and non-competitive systems.[25] Rates then can be justified on those cost differences rather than the complete range of costs limned in the NPRM. *Id.* at ¶ 73. Third, the Commission tenders that rates may be determined to be reasonable based on average costs for systems with similar characteristics. *Id.* at ¶ 74. Fourth, the Commission sets forth that rates associated with the need for capital to upgrade the system will be based not on all current costs, but simply on the costs for upgrading the system. *Id.* at ¶ 75. Finally, the Commission suggests that an exemption[26] from rate regulation

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[24] The CCPA deregulated rates for almost all cable systems on January 1, 1987. Only those cable systems that did not face competition from three over-the-air television signals were subject to local rate regulation.

[25] The polestar of the 1992 Act is to regulate rates so that they would be no higher than those charged by a cable system that faces effective competition. Thus, the Commission's cost studies, including its rate surveys, are designed to find the cost differences between systems. If the studies to not reveal any variation in costs, then the FCC can conclude that higher rates for systems that do not face effective competition are an effort by these operators to reap monopoly profits.

[26] The Commission is not certain whether such an exemption is possible. The 1992 Act provides that the FCC, in adopting

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might reduce burdens on small systems. Before addressing various rate regulatory alternatives, the appropriate definition of small cable operator must be addressed.

IV. *Definition of Small Cable Operator*

The Office of Advocacy opines that the 1,000 subscriber standard in the 1992 Act does not provide an adequate definition of small operator. First, many small systems are owned by much larger MSOs and have cost efficiencies not available to most smaller operators. Second, many operators beyond that 1,000 subscriber limit face many of the same administrative and resource constraints of systems with less than 1,000 subscribers.

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[26](...continued) rate regulatory standards, seek to reduce as much as possible the burdens on small systems (those with fewer than 1,000 subscribers).

Although the Office of Advocacy supports a total exemption from rate regulation for small systems, such an exemption raises two concerns. First, nothing in the Cable Act or the legislative history tenders even a scintilla of evidence that Congress intended to exempt such systems. Second, the Cable Act's reference to systems with fewer than 1,000 subscribers does not distinguish between those systems owned by large vertically-integrated MSOs and small independent operations. Given Congress' clear desire to regulate the cable industry, and large MSOs in particular, the Office of Advocacy finds it unlikely that the authors of the Cable Act had any intentions to exempt from regulation certain systems owned by these MSO's. Nevertheless, the Office of Advocacy believes that a properly crafted and a fairly limited exemption may be a viable alternative.

The Office of Advocacy recommends that the Commission adopt the Small Business Act definition of a cable operator -- one that is independently owned and operated and not dominant in its field. The SBA has determined that cable operators with less than 7.5 million dollars in gross revenue satisfy those criteria. Depending upon the rates charged, that standard is roughly equivalent to cable operations with approximately 20 to 25 thousand subscribers. This gross revenue figure applies irrespective of the number of systems[27] owned by a particular operator.[28]

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[27] Thus, a small cable operator may be a MSO. The FCC should draw a distinction between large MSOs and those MSOs that meet the definition of small business. Small MSOs, as detailed in Section II, *supra*, do not have the same resources as large MSOs. As a result, they more closely resemble independent single system operators and should be treated no differently.

This issue is relevant to the Commission's recent ruling on various stay petitions filed by small operators. The FCC granted a stay of its rate regulations for systems with fewer than 1,000 subscribers. In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, slip op. at ¶ 2 (August 10, 1993). The Commission also requested comment on whether systems with fewer than 1,000 subscribers owned by MSOs should be afforded the same regulatory relief as those individual systems with fewer than 1,000 subscribers. *Id.* at ¶¶ 22-25. For the purposes of meeting the Office of Advocacy's recommended definition of small cable operator, regulatory relief should be available to any system with fewer than 1,000 subscribers as long as the parent enterprise, if it is a MSO, is itself a small business under the 7.5 million dollar criterion. The Office of Advocacy takes no position on whether small systems owned by large MSOs should be afforded the same relief.

[28] The Office of Advocacy recognizes that the Commission may have to utilize some attribution rules for individual systems that are partnerships of other entities. Those attribution rules

(continued...)

The Office of Advocacy recognizes that substantial differences may exist within this category of small operators. To further refine the regulatory regime and account for the heterogeneity among small operators, the Office of Advocacy proposes that the FCC establish separate tiers for small operators akin to the tiering utilized in the regulation of LECs. From discussions with industry representatives, the most germane breaks (those systems with similar cost structures) appear to be at 1,000 subscribers, 3,500 subscribers, and 10,000 subscribers.[29]

This approach will allow the Commission to establish different cost-of-service regulatory requirements for each tier, such as the type or form of data. Such tiering will match more closely the characteristics of systems to their administrative resources. This tiering represents only one potential regulatory

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[28](...continued) should be based on distinctions between small and large firms, i.e., whether the partnerships or common stock ownership permit small firms access to volume program discounts, easier access to capital, or increases in administrative efficiencies; not whether a particular level of stock or partnership interest has been reached. *Cf.* In the Matter of Implementation of Sections 12 and 19 of the Cable Television Consumer Protection and Competition Act of 1992, Development of Competition and Diversity in Video Programming Distribution and Carriage, MM Docket No. 92-265, First Report and Order, slip op. at ¶ 31 (April 30, 1993) (cable operator attributed programming ownership when operator holds at least five percent of stock of program provider).

[29] The cost data that the Commission plans to amass may lead to the development of different cutoff points for various tiers.

alternative.[30] As described below, others exist that do not rely so heavily on conventional ratemaking procedures.

V. *Regulatory Alternatives*

The Office of Advocacy commends the Commission for its compliance with the RFA and its extensive examination of alternative regulatory regimes. The Office of Advocacy believes such alternatives are necessary because the benchmark system will not permit the recovery of costs for providing cable service in high cost areas or by the vast majority of smaller operators and such recovery is vital to the validity of rate regulation.[31]

A. Rates Prior to 1986

The Office of Advocacy cannot support the Commission's alternative to use 1986 rates adjusted for inflation and

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[30] Some industry data exists to suggest that some of the MSOs larger than the SBA cutoff face the same inherent problems as smaller operators. As a result, the Commission also may consider the establishment of tiers for operators with revenue in excess of 7.5 million dollars but less than 40 million dollars. A more accurate tier demarcation can be developed after an analysis of cost data collected by the FCC.

[31] The establishment of a regulatory regime that does not permit the recoupment of costs is confiscatory and violates the Constitution's prohibition on the taking of property without due compensation. *E.g.,* FPC v. Hope Natural Gas, Inc., 320 U.S. 591, 603 (1944); Bluefield Waterworks v. Public Serv. Comm'n, 262 U.S. 679, 690 (1923); Illinois Bell Tel. v. FCC, 988 F.2d 1254, 1260 (D.C. Cir. 1993).

productivity as an alternative for several reasons. First, these rates were the result of franchise bidding wars and often had little to do with economic reality.[32] It would be anomalous indeed for the FCC, in attempting to correct overcharging by some cable operators, to reimpose rates that a previous Congress found were untenable. Second, the rates in 1986 did not exposit the advent of pay-per-view, the equipment associated with the provision of pay-per-view capacity, and the vast increase in the number of cable programming channels available to operators. These technological advances and concomitant rebuilds of systems would not be accounted for in 1986 rates.

Even if the Commission selects this as a viable alternative, it should not do so for small operators. As the Office of Advocacy has pointed out in another context, the productivity of small common carriers (and for purposes of rate regulation cable operators have many of the characteristics of common carriers) varies dramatically from those of larger carriers.[33] Many small cable operators probably would not be able to meet the

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[32] H.R. REP. NO. 98-934, 98th Cong., 2d Sess. 21-22, *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS 4655, 4658.

[33] In the Matter of Policy and Rules Concerning the Rates for Dominant Carriers, CC Docket No. 87-313, Supplemental Notice of Proposed Rulemaking, Comments of the Chief Counsel for Advocacy at 6-11 (May 7, 1990). The Commission recognized this distinction in exemption smaller LECs from price cap regulation. In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, Report and Order, slip op. at ¶¶ 9-11 (June 11, 1993).

productivity factor selected by the FCC and thus would face the Hobson's choice of inadequate rates under the benchmark or the adjusted 1986 rates.[34] Such a prospect will not achieve the Commission's goal of ensuring that operators recover their costs.

B. Streamlined Cost-of-Service Showings

While the readjusted 1986 rates do not represent a viable regulatory alternative, the Commission's proposal to streamline cost-of-service showings does have potential for reducing administrative burdens, especially for smaller firms. The small firms that have contacted the Office of Advocacy do not object to cost-of-service regulation but desire that it be developed in a manner that does not overburden their already scarce administrative resources. The Office of Advocacy asserts that a properly tailored, streamlined cost showing will substantially reduce burdens on small operators while still permitting them to recover their costs.

The key component of any such streamlined regime is to identify the costs that differentiate small firms from large ones rather than the differences between cable operators that face

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[34] A more apt analogy might be the sword of Damocles. While Hobson's choices may be difficult, the failure of the thread holding the Damocletian sword is fatal. The Damocletian metaphor does not understate the dire circumstances that many small cable operators feel they face as a result of benchmark rate regulation.

effective competition and those that do not.[35] Most small firms believe that the key components are cost of capital (much greater for smaller firms), high wiring costs (due to the low density of population served), and programming costs. If a relatively simple form can developed to show what these costs are, many small firms will be able to use the cost-of-service showing without incurring substantial administrative costs. The acquisition of the necessary data to design the forms may, in the short-term, temporarily increase burdens on the FCC staff; however, the long-run savings to Commission personnel in avoiding review of reams of detailed cost data from thousands of operators will clearly outweigh these burdens.

Irrespective of whether the Commission adopts a streamlined rate-of-return regulatory scheme, the Office of Advocacy supports the FCC's proposal of an abbreviated cost showing for "significant capital expenditures." *Id.* at ¶ 75. Many small cable operators believe that they will need to make substantial improvements in their systems to stay competitive with other multichannel video delivery systems and provide the types of service and programming that their customers desire. The capacity to make such investments is not only necessary for the survival of these operators but a key component of the

[35] Thus, the Office of Advocacy opines that the FCC's focus on excess acquisition cost is misplaced and identification of these costs will not provide small operators with any significant relief.

telecommunications infrastructure of the next century.[36] In many rural areas, cable operators may be one of only two alternatives to provide that capacity. To deny these firms the capacity to make proper investments in technology could be relegating many rural areas to an inferior telecommunications infrastructure. Such bypass of rural America cannot be countenanced and these small operators should be provided the opportunity through rate regulation to amass the funds needed to rebuild and retool their systems.

C. Average Costs and the NECA Paradigm

The Office of Advocacy believes that the most beneficial proposal for the FCC, small cable operators, and their customers is to take a page from the Commission's regulation of LECs. There are approximately 1,400 LECs in the United States. All but about 50 are considered small by the Commission.[37] As the FCC

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[36] Cable systems will play a key role in providing alternative access to interexchange carriers and the ubiquitous points-of-presence needed to build personal communication service networks. In fact, a number of cable operators are attempting to develop such networks. In the Matter of Amendment of the Commission's Rules to Establish New Personal Communications Services, GEN Docket No. 90-314, Tentative Decision and Memorandum Opinion and Order, slip op. at ¶¶ 14-17, 24-29 (November 6, 1992).

[37] For certain regulatory relief examinations, the FCC defines small LECs as those with less than 50,000 local loop lines. In the Matter of Regulation of Small Telephone Companies, CC Docket No. 86-467, Report and Order, 2 FCC Rcd 3811 (1987). In other cases, the Commission uses divisions into tiers based on revenue. All carriers with more than 50,000 local loop lines are

(continued...)

notes in the NPRM, small LECs do not file independent cost showings with the Commission. Rather, many such firms elect to utilize tariffs based on average historical costs of carriers with similar characteristics. These carriers are known as average schedule companies. Maintenance of these average cost schedules and associated tariff filings are performed not by the individual LEC carrier but by an organization formed by all LECs at the behest of the FCC -- the National Exchange Carrier Association (NECA).[38] 47 C.F.R. § 69.601.

An organization could be established at the order of the FCC by the cable operators to provide the same functions for the cable industry that NECA does for the LECs. This organization could provide the administrative assets that most small operators do not have. This organization could easily develop appropriate average schedules, even for a variety of tiers, and file rates with the FCC and local franchise authorities. If average schedules are used and separate schedules are developed for different tiers of small cable operators along the lines suggested in Section IV, *supra*, then the Commission only would have to review three sets of terms, conditions, and supporting

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[37](...continued)
also categorized as Tier 1 carriers -- those with more than 100 million dollars in revenue.

[38] NECA also oversees the operation of pools to redistribute payments by interexchange carriers to LECs with high non-traffic sensitive costs. The operation of the pools is described in Commission regulations. 47 C.F.R. §§ 69.601-612.

cost data, not tens of thousands. Moreover, such an organization would be able to accumulate the sort of data needed by the Commission to properly tier small cable operations without unduly burdening the FCC staff. Similarly, the expertise of this organization could ease the review burden on thousands of local franchising authorities by providing concise and easily interpreted information needed to ensure the reasonability of basic service rates. Small cable operators then could devote their resources to system operation, not administrative function. The ultimate beneficiaries would be customers whose rates would not rise due to increases in administrative costs.

Membership in the organization should not be mandatory but the Office of Advocacy suspects that most small cable operators would willingly join such an association to avoid the enormous responsibilities associated with conventional rate regulation outlined in the NPRM.[39] For large cable operators, their costs, access to capital markets, and ability to utilize economies of scale in administrative areas (such as rate filings) would militate against their joining such an organization. On the other hand, the FCC permitting large cable operators to join would allow the organization to provide a more accurate data analysis since large firms often own and operate small systems.

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[39] Some small operators may cavil that their systems do not meet the average costs even if tiered to size of system. However, the Office of Advocacy believes that the cost efficiencies will outweigh the inaccuracies of average cost schedules.

One potential compromise may be for the FCC to allow large firms to permit their individual systems that, but for ownership, would satisfy the Office of Advocacy's proposed definition of small cable operator. This solution would ensure that small system customers, irrespective of the enterprise that owns the cable system, benefit from cost efficiencies associated with a NECA paradigm. To prevent large MSOs from obtaining these efficiencies in lieu of establishing their own in-house capability, the large MSOs would have to demonstrate that they could not provide the administrative cost savings associated with the NECA paradigm to their small system subsidiaries. In sum, the Office of Advocacy believes that the NECA paradigm, irrespective of membership criteria, has substantial benefits to small entities, customers, and the Commission.

D. Exemptions for Small Systems

The Commission offers the possibility of granting an exemption for systems with fewer than 1,000 subscribers. The Office of Advocacy believes that regulatory relief must go beyond the 1,000 subscriber limit for reasons discussed above. However, any exemption that the Commission develops should be limited to those operators that qualify as small businesses.[40] The Office

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[40] For systems of fewer than 1,000 subscribers that are owned by large cable operators, the streamlining procedures already delineated would satisfy the Congressional call for burden reductions on these systems.